

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 2003-512

September 19, 2003

MAINE PUBLIC UTILITIES
COMMISSION

EXAMINER'S REPORT

Investigation of Proposed Rate Design
by Verizon Maine to Eliminate Multiple
Rate Groups Through Consolidation
Into a Single Statewide Rate Group

NOTE: This Examiner's Report contains the recommendation of the Hearing Examiner. Although written in the form of an order, it does not constitute formal Commission action. Parties may file exceptions to this Report on or before **NOON** on **September 26, 2003**. We anticipate that the Commission will consider this Examiner's Report at its Deliberative Session on **October 1, 2003**.

I. SUMMARY

In this Order we conclude our investigation and find that Verizon's proposal to eliminate its six rate groups is reasonable. Verizon will file tariffs to implement one statewide average rate for all customer classes – with Economy and Premium options – to coincide with the implementation of the recent changes to the Basic Service Calling Area rule (BSCA), with an effective date no later than December 15, 2003.¹ The new rates will maintain the current \$1.50 per month difference between the Economy and Premium options for residential customers.

¹ The differential between Economy and Premium rates will be addressed in the proceeding we will open to address Verizon's rate proposal for implementation of the BSCA changes. See discussion at pages 5-6.

II. BACKGROUND

On July 9, 2003, Verizon Maine filed a proposal with the Commission to eliminate separate “rate groups” within its local exchange service rates. On July 22, 2003, we opened an investigation pursuant to 35-A M.R.S.A. § 1303(2) to determine whether Verizon’s proposal is reasonable and should be implemented.

In our recent rulemaking (Docket No. 2001-865) to amend the Basic Service Calling Area (BSCA) Rule, Chapter 204, Verizon proposed in its comments to eliminate separate rate groups within Verizon’s local exchange service rates. Verizon claimed it would make sense to eliminate rate groups at the same time it implemented the changes in BSCAs that would be mandated by the Rule.

“Rate groups” are a rate structure under which local service rates in various exchanges are based on the number of lines that a customer in that exchange can call without an interexchange toll charge, i.e., the number of lines in the customer’s BSCA. The rate for customers that have a larger calling area is higher than the rates for those that have smaller calling areas. Verizon has six rate groups, A through F, as shown in the table below. The difference between the residential rates in Rate Groups A and F is \$2.90 per month. The differentials for business rates are somewhat smaller (Premium, \$2.11; Economy, \$ 1.94).

Rate Group / # of Lines	Current Res Econ Rate	Current Res Prem Rate	Current Bus Econ Rate	Current Bus Prem Rate
RGA 0 – 1,100 lines	\$14.29	\$15.79	\$32.46	\$35.48
RGB 1,101 – 3,600 lines	\$15.13	\$16.63	\$33.20	\$36.25
RGC 3,601 – 11,000 lines	\$15.50	\$17.00	\$33.49	\$36.57
RGD 11,001 – 25,000 lines	\$15.91	\$17.41	\$33.79	\$36.91
RGE 25,001 – 50,000 lines	\$16.34	\$17.84	\$34.10	\$37.25
RGF 50,001 and up lines	\$17.19	\$18.69	\$34.40	\$37.59

In our Order Adopting Rule, we decided that Verizon's proposal was outside the scope of the rulemaking,² but we encouraged it to file a separate proposal. *Public Utilities Commission, Rulemaking to Amend Chapter 204, Basic Service Calling Areas*, Docket No. 2001-865, Order Adopting Amended Rule (Dec. 10, 2003) at 6. We noted that we were expressing no opinion or whether we ultimately would approve the change, but indicated that "the idea [was] worth considering." We agreed with Verizon "if such a change is appropriate, it may make sense to coordinate its timing with the implementation of the BSCA changes required by this Rule." *Id.* We therefore encouraged Verizon to propose any such change to its Terms and Conditions by a date

² The Notice of Rulemaking contained no proposal to eliminate rate groups, and potential commenters had no notice that such a proposal would be considered. We also noted that rate groups were an artifact of Verizon's Terms and Conditions, not the BSCA rule.

that was sufficiently early to allow full consideration by interested parties and the Commission reasonably in advance of the expected date for the BSCA expansions.

Under Verizon's proposal, the elimination of rate groups would be implemented on a revenue-neutral basis, resulting in statewide Premium and Economy rates for all customer classes. These rates would be equal to the weighted averages of the previous rates. Information provided by Verizon indicated that rates for customers in smaller rate groups would increase and rates for customers in the largest rate group would decrease. As proposed, the remaining rates would be between the present rates for Rate Groups E and F. Customers in Rate Group F (the largest rate group) would likely see a small net decrease.³

We issued a Notice of Investigation on July 22 and invited comments. The notice made Verizon, all other incumbent local exchange carriers and the Public Advocate parties. On August 22, 2003, we received comments from the Office of the Public Advocate (OPA) concerning Verizon's proposal.

³ Chapter 288, § 3(C)(2) requires rural LECs (i.e., LECs other than Verizon) that receive universal service funding (USF) to "establish local basic service rates that are no less than those of Verizon exchanges that have Basic Service Calling Areas of a similar size." Section 3(D)(1) states "The Commission may allow deviations from Verizon local exchange rates in individual exchanges if it is desirable to establish or preserve a rate design for a rural LEC, including disparities within and among exchanges that are a result of the operation of Chapter 204 (Basic Service Calling Areas), provided that, on an overall basis, the carrier's rates are no less than those of Verizon." Thus far, we are not aware of any USF recipient that has indicated that it wished to implement this "deviation." Accordingly, Verizon's proposal to eliminate rate groups could have the same effect on customers of the rural (independent) LECs that receive USF as it does on Verizon's customers.

III. DISCUSSION AND DECISION

Verizon, in the cover letter to its proposal, stated that two New England states in which it operates have approved similar restructurings of Verizon's basic exchange service rates through the elimination of the multiple rate classification structure.⁴ In these states Verizon has statewide uniform rates for business and residence basic exchange service. Verizon also stated that eliminating multiple rate groups improves the cost-price relationship for local service, offering a "more logical and understandable pricing format to consumers." According to Verizon, smaller, more rural exchanges generally are more costly to serve than larger, urban areas.

Verizon calculated a revenue-neutral, weighted average statewide rate for each of the four basic exchange calling options that would remain after rate group elimination (residential Premium, residential Economy, business Premium, and business Economy). For study purposes, the Staff requested the Company to provide an alternative that maintained the current difference between the Economy and Premium options for residential customers of \$1.50 per month.⁵ Under that alternative, the weighted average residential Economy rate would be \$16.67 per month and the residential Premium rate would be \$18.17 per month.

⁴ In 1990, Massachusetts eliminated rate group classifications and Vermont phased in a similar plan during 1996-2000 that transitioned to uniform rates.

⁵ Under this alternative, neither the Premium nor the Economy residential rates would be revenue neutral, but revenues for the residential class as a whole would remain unchanged.

We do not decide in this case that these will be the final rates or that \$1.50 will be the final spread between Premium and Economy. We will decide those issues in the proceeding we will open when Verizon files its BSCA rate proposals. We note, however, that Section 5(A)(2) of Chapter 204 generally requires a greater portion of the rate increase for the recovery of lost BSCA revenues to be placed on the option (here, Premium) that receives the greater increase in flat-rate unlimited calling. The provision does allow exceptions, however.⁶

On August 22, 2003, the OPA filed comments that provided two alternatives to Verizon's proposal. The first was to "table" Verizon's proposal until the conclusion of our proceedings in Docket Number 1999-851 (Investigation into Verizon Maine's Alternative Form of Regulation – Post Remand). The OPA believes that those proceedings could result in excess revenues that could be used to fund BSCA expansions and rate group consolidation without increases to local rates. We recently decided the issues in that proceeding and decided that we will not conduct a rate

⁶ Section 5(A)(2) states:

2. Options. Generally, when the number of exchanges in a BSCA increases, the rates of the option that receives the greater change in flat-rate unlimited calling should increase by a relatively greater amount than the rates for the other option. A LEC may propose a different balance if:

a. Increasing the rates for the economy option would result in rates for the two options that are too similar; or

b. The rates for the premium option would be so high that they would be likely to deter customers from subscribing to that option.

See discussion of this provision in *Public Utilities Commission, Rulemaking to Amend Chapter 204, Basic Service Calling Areas*, Order Adopting Amended Rule (December 10, 2002) at 10-11, 14-15. The latter pages state "Some increase to the Economy option rate is acceptable even though there is no change in the flat-rated portion of the Economy option, because Economy customers benefit by being able to call the new areas in the BSCA for 5 cents a minute rather than incurring a toll charge."

proceeding either for the purpose of satisfying the “objective” in 35-A M.R.S.A. § 9103(1) that rates during the course of an AFOR be no higher than under rate-of-return regulation (ROR) or for the purpose of resetting the starting point of the AFOR. We therefore reject this proposal by the Public Advocate.

The OPA’s second alternative would modify the current six-rate group structure to two rate groups – an urban group and a rural group. The OPA states that this would more accurately reflect the continued distinction between the access lines within rural and urban calling areas. The OPA did not propose a specific definition of “rural” or “urban” rate groups, although it presumably means to draw a distinction between customers who can call fewer numbers of lines and those who may call greater numbers. The OPA suggested that this structure could be short term with an eventual transition to one statewide rate.

The OPA states “(V)alue of service concepts should continue to be a factor in rate setting because equity and customer acceptance goals continue to be important regulatory goals.”⁷ The OPA apparently believes that rate groups, whether the current six, or the alternate two, better reflect the “value” received by customers. The Public Advocate’s apparent assumption, which also underlies rate group pricing, is that being able to call more lines on a toll-free basis is more valuable to customers than being able to call fewer lines. The OPA’s argument fails to recognize that the calling areas of

⁷ “Value of service,” was a term used by Theodore Vail, President of AT&T, to advance his idea of “universal service,” in the early 1900s. “Its (a telephone’s) value depends on the connection with other telephones – and increases with the number of connections.” Mueller, Jr., *Universal Service* (1997)(quoting from AT&T, 1908 Annual Report).

“rural” exchanges will be substantially greater after the addition of all contiguous exchanges to all BSCAs, thereby diminishing the calling area differences between “rural” and “urban” BSCAs.

We believe now is an opportune time to allow Verizon to eliminate rate groups completely because the imminent expansion of BSCAs to include all contiguous exchanges will already go long way toward that end. According to information provided by Verizon during the recent BSCA rulemaking process, many smaller exchanges would “migrate” to larger rate groups as the number of lines within BSCAs increased. The smallest rate group (Rate Group A, presently with five exchanges) would be eliminated entirely and Rate Groups B and C will have very few exchanges and customers. By operation of the BSCA expansion and the accompanying rate group migration (if rate groups were not eliminated), one Rate Group A exchange would move to Rate Group B, three would move to Rate Group C, and one would move to Rate Group D. Rate Group B, which currently has twelve exchanges, would contain only four after the expansion; Rate Group C, currently with 30 exchanges would have 18. However, Rate Group F, currently with 27 exchanges, would have 44 after the expansion. As reflected in the rate group migration that would occur, if rate groups are not eliminated entirely, many customers in smaller exchanges will be able to call a greater number of lines without toll charges. It follows that there will be a reduction in the disparity in calling area size between smaller and larger exchanges.

From at least one “value of service” perspective (additional value received for additional rates), the rates for customers who receive the greatest increases in their calling areas will increase more than those for customers whose calling areas increase

less (or not at all). A substantial portion of the rate increases would result from movement from one rate group to another (if rate groups were not eliminated); for most customers, that effect would be greater than the effect on rates from the rate group elimination. Only 1.62 percent of Verizon's current residential customers who subscribe to the Premium option⁸ are located in exchanges classified as Rate Group A. If rate groups are eliminated, all of these Rate Group A customers would all face a total increase of \$2.98, attributable to three effects: rate group migration, an assumed \$0.60 for the addition of contiguous exchanges to BSCAs⁹ (both of which will occur in any event), and rate group elimination. If rate groups are not eliminated, much of the increase for Rate Group A would occur anyway because of rate group migration and BSCA increases. Twenty percent of the Rate Group A residential Premium customers (or 0.32% of all residential Premium customers) would migrate to Rate Group B, which for those customers would result in an increase of \$0.84; \$0.60 of the increase is attributable to BSCA and \$1.54 to rate group elimination. Sixty percent of Rate Group A residential Premium customers would migrate to Rate Group C, which would result in an increase of \$1.21; \$0.60 is attributable to BSCA and \$1.17 to rate group elimination.

⁸ We have chosen residential Premium customers for the examples provided here because they are the largest group of customers in all exchanges. Changes for residential Economy and for business customers would be similar.

⁹ The 60 cents is an approximation. Verizon has provided a "rough" calculation of average toll revenue loss per line of \$.62 if it is not required to reduce access rates to current interstate levels and \$.59 if it is required to make such a reduction prior to the implementation of the BSCA changes. As discussed above, rate design considerations may require a greater increase to be placed on the Premium rate than on the Economy rate.

The timing of Verizon's next access rate reduction is the subject of *Public Utilities Commission, Investigation of Compliance of Verizon with Amended 35-A M.R.S.A. § 7101-B*, Docket No. 2003-358.

Twenty percent of Rate Group A residential Premium customers would migrate to Rate Group D, which would result in an increase of \$1.62; \$0.60 is attributable to BSCA and \$0.76 to rate group elimination.¹⁰

Rate Group B residential Premium customers (2.3 percent of all residential Premium customers) would face a total rate increase of \$2.14 resulting from the three effects. For 25 percent of the rate Group B customers, there would be no rate group migration if rate groups were retained. For them the marginal effect attributable to rate group elimination would be \$1.54 (after \$0.60 for BSCA). For the 25% who would migrate to Rate Group C, the marginal rate group elimination effect would be \$1.17; for the 41.7 percent and 8.3 percent who would migrate to Rate Group D and E, respectively, the marginal effects would be \$0.76 and \$0.33.

Of the Rate Group C residential Premium customers, 40 percent would stay in Rate Group C if rate groups were not eliminated. The marginal effect of rate group elimination for those customers would be \$1.17. For other Rate Group C customers the marginal effect of rate group elimination would be \$0.76 or \$0.33.¹¹

¹⁰ As discussed above, rate group elimination is "revenue neutral." One of the effects that of that elimination, however, is that the additional local service revenues that previously resulted from rate group migration will not occur. Previously, additional local service revenues generated by rate group migration were used to offset some of the retail toll and access revenue losses caused by the expansion of BSCAs. The overall average effect on local service rates is the same, however, whether rate groups (and rate group migration) are eliminated or not. The amounts that some customers do not pay as a result of not migrating to a higher rate group are instead paid by customers (not the same mix of customers, of course) as part of the BSCA surcharge. In other words, the BSCA surcharge will be higher than it would be if rate group migration continued, but Verizon's overall local rates will be the same.

¹¹ The total increase for Rate Group C, taking into account the effects of rate group migration, BSCA, and the marginal effect from rate group migration, would be

The marginal effect from rate group elimination would exceed \$1.00 for only 6.8 percent of all residential Premium customers. The marginal effect for 15.5 percent would be \$0.76 and for 20.8 percent, \$0.33. The marginal effect for 56.9 percent of residential Premium customers would be negative (-\$0.52).

The present relationship between cost and price is most likely inverse. Rural customers typically are served by longer and less densely populated loops that are more costly per customer; densely populated urban areas generally have lower costs per customers. The elimination of multiple rate groups begins to correct that imbalance. While we do not wholly reject the Public Advocate's argument that "value of service" should play a role in rate design, we have also encouraged and implemented cost-based pricing for most utility services. In this instance, the two policy directions conflict with each other. "Value of service" pricing, in the Public Advocate's view, would suggest maintaining the current rate structure in which customers with smaller calling areas (as defined by the number of lines a person can call) would have lower rates than those with larger calling areas. Cost-based pricing, on the other hand, would most likely result in higher rates for low-density, rural exchanges (that happen, usually, to have smaller calling areas) and lower rates for urban, high-density exchanges that normally have larger calling areas. The elimination of rate group pricing constitutes a step away from value of service pricing toward cost-based pricing, but it does not eliminate value of service as a pricing consideration.

\$1.77. The total increase for Rate Groups D, E and F, respectively, would be \$1.36, \$0.93 and \$0.08.

We note also that rate group pricing (and the Public Advocate's assumptions about "value of service") is based solely on the number of lines that a person may call without a toll charge. That consideration is not necessarily the sole measure of value, however. If a small exchange's calling area includes contiguous exchanges and one or more service centers within a reasonable traveling distance, a customer in that exchange may be able to call most of the other lines he or she has an interest in calling. Such a calling area may have as much "value" as the calling area of an exchange located in an urban area that allows a customer to call many more lines within a similar geographic area. It does not necessarily follow that being able to call four times as many lines is four times as valuable. In short, distance is a factor that should be considered in any value of service "calculation." Our concern with rate increases to those customers with the lowest rates, and smallest calling areas, is ameliorated by the significant expansion of most of those customers' calling areas.

For all of these reasons, we agree that Verizon's proposal to eliminate its six rate groups is reasonable, and we therefore conclude our investigation in this docket. As part of its rate proposal for implementation of the BSCA changes scheduled for December 2003, Verizon shall file tariffs that implement statewide average rates for all basic service customer classes, with Economy and Premium options for each class.

The tariffs shall bear an effective date no later than December 15, 2003. With the filing, Verizon shall provide information stating the amount of the proposed change to each rate that is attributable to the elimination of rate groups (i.e., quantification of the movement of that rate to an average rate) and to BSCA revenue loss.

Respectfully submitted,

Peter Ballou
Hearing Examiner